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SUBJECT: South China Civil Aviation: Views on Subsidies,
Expansion, and Market Liberalization

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protect accordingly.

¶1. (SBU) SUMMARY: Major airlines in South China admit
subsidies are available from local governments to offset
losses from flying less traveled domestic routes. One
airline mentioned they received subsidies for international
flights. The airlines have limited expansion plans for the
overseas market. Local private airlines will continue to
increase their aircraft fleet size and expand operations in
the short-distance domestic market sector. All airline
companies expressed concern over the increased competition
from market liberalization. END SUMMARY.

¶2. (U) Post contacted three major airline companies in the
Consular district - China Southern Airlines, Hainan
Airlines and Shenzhen Airlines - to garner their views on
media reports of government subsidies, airline expansion
plans, and market liberalization.

Subsidizing Less Traveled Routes

¶3. (SBU) China Southern Airlines officials said they used
to receive cash subsidies from some local governments for
operating routes to less traveled areas. Given the high
costs and low demand, China Southern began to eliminate
some less traveled routes several years ago despite the
subsidies. The China Southern official noted that the
airline does not currently receive any government subsidy
for operating domestic routes.

¶4. (SBU) According to Hainan Airlines representatives,
individual airline companies can get some form of subsidy
for less traveled domestic routes from local governments
instead of the Central Government. Local governments
usually provide incentives, such as low airport costs or
cash subsidies, to attract airlines to open routes to those
areas. Subsidy levels are determined on a case-by-case
basis. According to Shenzhen Airlines officials, the
Central Government does provide subsidies for international
routes, noting that no airline company is making a profit
on international flights.

¶5. (SBU) An official from China Southern Airlines denied

the news that RMB 10-20 billion (USD 1.3-2.6 billion) worth of subsidies would be given to the three major airlines by the Central Government. The official complained that the Central Government requires the airline to procure a large number of aircraft that subsequently become a heavy financial burden to maintain and operate, especially with rising fuel prices. A Hainan Airlines official said that such subsidies (if the story is true, he noted) would be reserved for the state-owned giants, not for a private company like Hainan Airlines. A Shenzhen Airlines representative also believed it unlikely Shenzhen Airlines would receive such subsidies from the government.

Expansion Plans

¶6. (SBU) In 2007, China Southern Airlines plans to focus on the domestic market and further develop its transportation hubs in Guangzhou and Beijing. It plans to increase domestic passenger capacity by 15% by adding 30 additional aircraft to its domestic routes. Two new international routes, Guangzhou to Lagos and Guangzhou to Kathmandu, were opened in January 2007. China Southern does not have any plans to open more international routes, as they are not profitable, nor does it plan to purchase more aircraft this year. A China Southern official does not expect the airline to merge with other domestic airlines in 2007; the priority is to incorporate and streamline recently acquired businesses into their operations.

¶7. (SBU) Hainan Airlines will expand their aircraft fleet size by buying 10-20 planes each year until the total number reaches 400 or 500. Hainan Airlines recently signed

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a contract with Brazil to buy 100 ERJ planes; delivery is expected to begin this year. Shenzhen Airlines also plans to expand the number of its planes to 80 by 2008, and to 160 by 2015.

¶8. (SBU) Hainan Airlines hopes to expand its international presence in 2007. It will open a route to Siberia in February and hopes to conclude negotiations establishing a flight to Boston. Domestically, Hainan Airlines will continue to expand by merging with small province-based airlines, such as Xiangpeng Airlines in Yunnan Province.

¶9. (SBU) Shenzhen Airlines will continue to focus on the domestic market, especially cargo flights. Shenzhen Airlines plans to expand operations in the short-distance, or "branch route," market.

Market Liberalization

¶10. (SBU) China Southern Airlines representatives expressed concern over market liberalization. They believe market liberalization will bring in more competition that will impact China Southern Airlines' bottom line. China Southern hopes that the Central Government will give them more support as it faces challenges from private domestic airline companies.

¶11. (SBU) Hainan Airlines officials confessed that market liberalization will also hurt the Airlines' business. The airline hopes to meet the challenge through continued expansion. Shenzhen Airlines plans to deal with liberalization by increasing cooperation with foreign partners. In December 2006, Shenzhen Airlines signed an agreement with Mesa Air Group Inc. to set up a joint venture using 50-seat planes for domestic short-distance flights. The joint venture would likely begin operations within the first year.

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